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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the	)	CC Docket No. 96-128
Pay Telephone Reclassification	)	
and Compensation Provisions of the	)	
Telecommunications Act of 1996	)	

AT&T Petition for Reconsideration

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SUMMARY

The Second Report and Order ("Second Order") is riddled with factual and conceptual errors that should be rectified on reconsideration -- particularly because the effect of the errors is to impose excessively high costs on carriers and consumers. This is directly contrary to the mandate and the purpose of Section 276, which permits and contemplates the payment of only "fair compensation" to payphone service providers ("PSPs").

First, the order proceeds from the erroneous premise that the Court of Appeals endorsed a "market-based" approach to per-call compensation for coinless calls when in fact the court made no such finding. Second, the order simply ignores record evidence that local coin calls and coinless calls are not even in the same market. Thus, it was clearly irrational for the order to attempt to derive payphone service providers' ("PSPs'") costs for coinless calls from the presumed market rate for local coin calls. The only rational way to correct these errors is to adopt a bottom up cost-based approach that is based upon PSPs' forward-looking efficient costs, as AT&T and others advocated on remand.

But the Second Order's errors are not limited to its methodological choice. The order acknowledges that LECs, and particularly the RBOC/GTE/SNET Coalition, did not provide usable cost data. Thus, all of the order's cost analyses are based on the unsupported and fundamentally false premise that the costs of independent payphone providers ("IPPs") -- who own only 20-25% of all payphones -- are representative of the PSP industry as a whole. This premise was not only rebutted by evidence in the record regarding the costs of Sprint and NYNEX, it is conclusively disproved by evidence regarding SBC which has only recently become available for use. These data show that the total costs of LEC PSPs -- who own the

vast preponderance of payphones -- are well under half the reported costs of IPPs. Thus, none of the calculations in the Second Order are based on complete and reliable information, and all of them must be recomputed, taking into account the LECs' data.

Finally, even if the Commission were to continue to apply an economically unsound top down avoided cost analysis, the analysis in the Second Order should be revised in four respects. First, the order inappropriately began its calculations at the highest rate in the marketplace, without explaining why it did not even consider applying lower rates that were also charged in the market. Second, the order ignored that its calculations rewarded PSPs with an excessive profit margin for coinless calls that is higher than the margin for local coin calls. Third, the order assigns an inadequate amount to PSPs' avoided costs for local call completion based on an analysis that is directly inconsistent with its own analysis of the costs of payphone sets. Last, the recent data provided by USTA invalidate the figures used to calculate the cost "add-on" related to implementation of Flex ANI and show that this add-on should be eliminated.

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AT&T PETITION FOR RECONSIDERATION

Pursuant to Section 1.429 of the Commission's Rules, AT&T Corp. ("AT&T") respectfully petitions the Commission to reconsider the Second Report and Order released on October 9, 1997 ("Second Order") in the above-captioned proceeding.[1]

INTRODUCTION

The Second Order readopts the "market-based" approach to payphone compensation in the Commission's First Report and Order and sets the default per-call compensation rate for coinless calls at 28.4 cents per call until October 7, 1999 and at the market rate for local coin calls at each individual payphone minus 6.6 cents thereafter. Reconsideration of the Second Order is necessary, because, in its effort to implement a market-based approach for compensation rate carriers must pay to payphone service providers ("PSPs"), the order failed to apply reasoned decision making, as required by the Administrative Procedure Act.[2] In

[1] AT&T understands that MCI has filed a petition for review of the Commission's Second Order and moved for a stay of that order pending appeal. AT&T concurs with the merits of MCI's position, but has instead filed this Petition for Reconsideration to provide the Commission an opportunity to correct the flaws in the Second Order. AT&T reserves, however, all of its rights to pursue appellate review of the Second Order.

[2] See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co., 463 U.S. 29 (1983).

particular, the Second Order did not consider the arguments and evidence of AT&T and other commenters which showed that its market-based approach was internally inconsistent, and that the cost evidence upon which the order is based was unrepresentative and biased. The result of the order's failure "to consider responsible alternatives to [the Commission's] chosen policy,"[3] is that the default compensation rate for coinless calls is significantly above the "fair" compensation permitted by Section 276 of the Telecommunications Act of 1996 ("the Act").

Reconsideration of the Second Order is also required so that the Commission can consider two categories of additional evidence that were not available during the remand proceeding. The first category provides data regarding the costs of LEC PSPs, who own the vast preponderance of payphones yet offered virtually no detailed, credible information on their costs, even though such information was specifically requested by the Commission. These new data provide further support for AT&T's showing on remand that the average cost of coinless calls from payphones is far below the amount calculated in the Second Order. These data also completely undercut the order's fundamental assumption that the cost data provided by independent payphone providers ("IPPs") are representative of the costs of all PSPs. The second category of new evidence shows that the costs of implementing Flex ANI are an order of magnitude less than those assumed in the Second Order, which requires the elimination of the cost "add on" for Flex ANI implementation.

In light of the above, the Commission should reconsider the Second Order and reject its market-based approach to compensation for coinless calls in favor of a bottom up cost-based approach similar to the one proposed by AT&T and other commenters on remand. In all events, the record clearly shows that IPP costs are not representative of -- and indeed are much higher than -- the costs of the payphone industry as a whole. Thus, the Commission must recompute all of the cost analyses in the order, taking into account cost data for LEC PSPs.

[3] Farmers Union Cent. Exch., Inc. v. FERC, 734 F.3d 1486, 1511 (D.C. Cir. 1984).

Moreover, even if the Commission persists in applying the economically unsound top down market-based approach to payphone compensation, it should begin at 25 cents, remove excessive profits, increase the deduction for the cost of local call completion to 5-8 cents and eliminate the cost "add-on" for Flex ANI implementation.

ARGUMENT

I. Contrary to the Second Order's Assumption, The D.C. Circuit's Decision Vacated The Compensation Scheme Adopted In The First Report And Order, And In No Way Endorsed A "Market Rate" Approach.

In its decision rejecting the First Report and Order ("First Order") in this proceeding, the D.C. Circuit concluded that the default rate established for coinless payphone calls -- which was based on an assumed deregulated rate for local coin calls -- was arbitrary and capricious. Illinois Pub. Tel. Ass'n v. FCC, 117 F.3d 555, 564 (D.C. Cir. 1997). The court further clarified that the regulations based on this approach were "vacated" and that there was "little or no prospect that the rules being readopted upon the basis of a more adequate explanation of the agency's reasoning." Illinois Pub. Tel. Ass'n v. FCC, 123 F.3d 693, 693 (D.C. Cir. 1997). Despite these clear statements from the court, the Second Order essentially adopted the pricing standard of the First Order with only minor modifications. These modifications, however, are insufficient to correct a methodology that the D.C. Circuit aptly characterized as "inexplicable." 117 F.3d at 564.

In particular, the Second Order (¶ 29) again determined that the compensation for providing access code and subscriber 800 calls should be calculated using the rate that PSPs charge for local coin calls in deregulated markets -- i.e., a "market rate." In so doing, that order (¶¶ 23-24) misread Illinois Pub. Tel. Ass'n as essentially endorsing the basic "market rate" approach for per-call compensation. According to the order (¶ 23), the only thing required by the D.C. Circuit's decision was to "respond to information on the record regarding the cost disparities between the cost of providing coin calls and subscriber 800 and access code calls." The Second Order then purports to address this concern by a simple modification of the earlier compensation rate standard -- i.e., removing from the market rate for local coin calls any cost "avoided" when providing coinless calls. Id., ¶¶ 41-63.

This reading of Illinois Pub. Tel. Ass'n cannot withstand review. Contrary to the Second Order's assumptions, the court did not reach the merits of the First Order's market rate approach. Having held that the First Order's assertion that the cost of coinless calls was exactly equal to the rate for coin calls was manifest "ipsi dixit" (117 F.3d at 564), the court did not need to go further and determine whether the costs of coinless calls could -- on the basis of an approach not presented to it -- somehow be divined from the market rate for coin calls. Indeed, it is noteworthy that the Second Order was unable to cite any language from the Illinois Pub. Tel. Ass'n decision that even purports to sanction the use of a market rate for payphone compensation.[4]

II. The Second Order's Modified Market Rate Approach Ignores Record Evidence That Conclusively Demonstrates That The Standard Used Is Arbitrary And Irrational.

In arriving at a modified market rate approach, the Second Order wholly ignores overwhelming evidence that this standard was internally inconsistent and contrary to sound economic theory.[5] In the remand proceeding, AT&T's economic expert Dr. Frederick Warren-Boulton explained that "local coin calls and coinless toll calls are independent goods."[6]

[4] The only reference made by the court to a "market-based approach" was in the part of its decision referring to the deregulation of rates for local coin calls. 117 F.3d at 562-63 (Part II.A). This, of course, provides no support for the First Order's establishment of a compensation rate for coinless calls, because such calls, unlike local coin calls, are not constrained by effective competition. See pp. 4 - 6 below.

[5] See Illinois Pub. Tel. Ass'n, 117 F.3d at 564 (the "failure to respond to contrary arguments resting on solid data, epitomizes arbitrary and capricious decision making") (citing Motor Vehicle Mfrs. Ass'n, 463 U.S. at 46-57).

[6] AT&T Reply Comments, Declaration of Dr. Frederick Warren-Boulton at 2.

Thus, the two different types of calls from payphones have independent demand and are not substitutes for one another. Moreover, Dr. Warren-Boulton showed that coin-specific costs are not "joint and common" with costs of coinless calls because "[l]ocal coin calls are effectively a final product provided by the pay phone operator, whereas pay phone access to coinless toll calls is only one input to a toll call."[7] As a result, the PSP faces a "final demand for local coin calls and a derived demand for pay phone access to toll calls," so that the rate for the former cannot be used to calculate the costs of the latter.[8] And, as Dr. Warren-Boulton explained, tying payphone compensation for coinless calls to the rates for local coin calls, would provide PSPs with an incentive to raise the price of local coin calls above the profit-maximizing level in order to increase their total return.[9]

Put simply, the record shows that a market-based approach to setting the default payphone compensation rate must recognize that there are two independent markets that must be considered: the markets for coin calls and for coinless calls. Moreover, the record shows that a market-based approach to payphone compensation will encourage higher prices for both local coin and coinless toll calls, even if the market for local coin calls is vigorously competitive. Nevertheless, the Second Order does not discuss either of these important issues.

The Second Order's insistence on linking local coin rates and certain avoided costs for calls in a different market also defies common sense.[10] Local coin calls are over 70 percent of

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[7] Id.

[8] Id. (emphasis in original).

[9] Id. at 6.

[10] See generally, ex parte letter from E. E. Estey, AT&T, to William F. Caton, CC Docket No. 96-128, dated October 1, 1997 ("AT&T October 1 ex parte"); ex parte letter from R. H. Castellano, AT&T, to William F. Caton, CC Docket No. 96-128, dated September 24, 1997 ("AT&T September 24 ex parte").

total calls from payphones and, as the PSPs have conceded, drive the economics of payphones.[11] Moreover, the relationship between the participants in these two markets is fundamentally different. In the local coin market, there is a direct relationship between the customer (the caller) and the service provider (the PSP). If the PSP sets a price the caller does not want to pay, the caller can costlessly choose not to make a call. By contrast, in the coinless toll market, the caller does not provide the PSPs' compensation; instead, payphone compensation for coinless calls comes from the carrier. The carrier, of course, cannot directly control where or when a customer will place a call. Indeed, the only steps a carrier can take (absent direct rate regulation) to prevent a PSP from assessing an exorbitant charge is to monitor every call placed by its customers from payphones and block calls made from high cost payphones. This is of particular concern for the "permanent" default rate that will be based on the individual local coin rate charged at each of more than two million payphones. Far from being costless, carriers' costs for constructing a blocking capability that requires them to keep track of and identify the price charged at every individual payphone would likely be well over a hundred million dollars (see AT&T Comments at 17).

Contrary to the Second Order's (¶ 97) suggestion, a carrier's ability to block calls does not give carriers "significant leverage within the marketplace to negotiate lower per-call compensation amounts." Rather, as the D.C. Circuit expressly observed in Illinois Pub. Tel. Assoc., the fact that rates "might be adjusted by negotiation does not negate" the right "to a default rate that is reasonably justified." 117 F.3d at 564. In this regard, the court also recognized that "blocking is hardly an ideal option for the IXCs, for it is not only expensive to implement . . . but its use invariably will result in a mutual loss of benefits for both the PSPs

[11] AT&T Reply at 20 n.20 (citing comments of Peoples (at 6) , Coalition (at 16), CWI (at 7), CompTel (at 12), LCI (at 6)).

and IXCs."[12] Thus, the fact that the local coin call market might be vigorously competitive does not constrain the rates PSPs could charge carriers for coinless toll calls made by those carriers' customers; indeed, as Dr. Warren-Boulton stated, the market-based approach will cause rates in both the local coin market and the coinless market to rise. And in all events, the fact that these two types of calls are "independent goods" means that the rates for coin calls provide no basis for calculating the costs of coinless calls.

III. Compensation for Access Code And Subscriber 800 Calls Should Be Set Based On A "Bottom Up" Calculation Using A Forward-Looking, Economic Cost Standard.

Given the unavoidable problems with the Second Order's market-based approach, the only rational way to set prices for coinless calls is to calculate costs from the "bottom up" using a forward-looking, economic cost standard. It is beyond dispute that such an approach would yield the "fair compensation" required by the Act. In fact, it was precisely the failure of the First Report and Order to set a cost-based rate for subscriber 800 and access code calls that led the court to vacate the initial default rate regulations. See Illinois Pub. Tel. Ass'n, 117 F.3d at 563-64.[13] Furthermore, the Commission itself has repeatedly recognized that costs

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[12] Id. The Second Order's reasoning is further undermined by the fact the Common Carrier Bureau granted a five month waiver of the rules that required LECs to implement (and PSPs to send) the Flex ANI coding digits necessary for carriers to block calls. Implementation of the Pay Telephone Reclassification and Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128, DA 97-2162 (CCB Oct. 7, 1997) ("Bureau Waiver Order"). This waiver eliminates any possibility that carriers could block calls from payphones that do not transmit the required digits.

[13] Courts have repeatedly held that where, as here, competition is insufficient to constrain prices, regulated rates should be based on the cost of providing the service at issue. E.g., Farmers Union, supra.

should be the basis for setting payphone compensation rates.[14] And except for PSPs, the commenters in this proceeding uniformly agreed that the only "fair compensation" rate was one based on cost. See AT&T Reply at 1 n.2.

Moreover, only cost-based rates will promote efficient competition for local coin calls. If compensation for coinless calls is used to subsidize the pricing for local coin calls -- counter to the statutory intent to eliminate subsidies[15] -- it will distort competition in the local coin market by dampening PSPs' incentives to operate efficiently. AT&T Reply at 9-12.

It also cannot be disputed that forward-looking, economic costs are the only costs that are economically significant. A forward-looking cost methodology provides "strong incentives to manage their affairs well and to provide efficient service to the public," Duquesne Light Co. v. Barasch, 488 U.S. 299, 209 (1989), and "serve[s] as a surrogate for competition" by "enforc[ing] a competitive standard on . . . rates in the absence of any real competitive alternative." Potomac Elec. Power Co. v. ICC, 744 185, 194 (D.C. Cir. 1984). By contrast, forcing carriers to pay for payphone calls based on PSPs' high historical costs would deprive consumers the benefits of effective competition. Indeed, in light of the virtues of a forward-looking cost standard, the Commission has reviewed rates on this basis in a wide variety of settings, both before and after the passage of the 1996 Act.[16]

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[14] Policies and Rules concerning Operator Service Access and Pay Telephone Compensation, 7 FCC Rcd. 3251, 3255-56 (1992); Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, 11 FCC Rcd. 6716, 6736 (1996).

[15] Section 276(b)(1)(B).

[16] See, e.g., Open Network Architecture Tariffs of Bell Operating Cos., 9 FCC Rec. 440, 455-56 (1993) (enhanced data services); Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services In Michigan, CC Docket No. 97-137, ¶¶ 281-94 (Aug. 19, 1997) (local exchange services); Application of NYNEX Corp. and Bell Atlantic Corp. for Consent to Transfer Control of NYNEX Corp. and Its Subsidiaries, File No. NSD-L-96-10, ¶¶ 13, 185

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The Commission did not -- and could not -- dispute that use of a forward-looking, efficient cost methodology would lead to efficient payphone rates and efficient deployment of payphones. Rather, the Commission claimed that (1) an economic cost standard would "not promote deployment of payphone services" (Second Order ¶ 93); (2) a cost-based approach may be "difficult" to implement (id. ¶ 97); (3) payphones are not bottleneck facilities (id. ¶ 94); and (4) the incremental cost approach advocated by AT&T would not allow for the recovery of the sizable common costs at issue (id. ¶ 96). None of these objections is persuasive; rather they underscore the Commission's failure to engage in reasoned decision making.

First, there is no basis for the Second Order's belief that inflated compensation for coinless calls is needed to subsidize greater deployment of payphones. Compensation for such calls based on economic costs will, by definition, help promote efficient deployment of payphones. And there is no need for an additional subsidy. As AT&T demonstrated in the remand proceeding, the market deals with the deployment of non-economic payphones through the mechanism of "semi-public" phones, which are supported by direct payments from location owners. AT&T Reply at 11 n.25; AT&T Oct. 1 ex parte. And in all events, the Act makes clear that the "fair compensation" that should be paid to PSPs should not include above-cost subsidies by expressly providing for "public interest payphones." 47 U.S.C. § 276(b)(2).

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(Aug. 14, 1997) (same); Federal-State Board on Universal Service, FCC 97-157, ¶ 223-36, 250 (Nov. 8, 1996) (universal service subsidies); Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, 11 FCC Rec. 5020, 5043 (1996) (CMRS interconnection);

See AT&T Reply at 10. Tellingly, the Second Order also failed to address either of these arguments.[17]

Nor, as the Commission mistakenly believed, will use of forward-looking costs reduce the deployment of payphones from current levels.[18] Indeed, the opposite is true. Regardless of the charge ultimately set by the Commission, PSPs will have the ability to: collect 0+ commission revenues; increase local coin rates to whatever the market will bear (irrespective of their costs); and recover for the first time substantial compensation for originating both subscriber 800 calls and intrastate access calls. AT&T September 24 ex parte. Thus, compensation for coinless call that are based on efficient costs would not reduce the number of payphones but would necessarily -- and substantially -- increase PSPs' prior revenues from each existing payphone. AT&T Reply at 10-12.

Second, there is no practical barrier to implementing a bottom up cost study. Indeed, the Second Order's findings in this regard are flatly contradicted by the fact that the Commission itself was able to conduct such a study (albeit one that relied on faulty data). AT&T's comments and ex parte presentations on remand further confirm that such a study is practical and easily implemented, because the costs directly attributable to coinless calls are readily identified and quantified.

Third, rate regulation is appropriate where, as here, competition does not constrain prices. The market for coinless calls is, at most, imperfectly competitive. Indeed, as noted

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[17] The Second Order's rejection of forward-looking, economic costs in favor of embedded costs is not the only means by which it chose to subsidize PSPs at the expense of carriers and consumers. The order also determined the default rate with reference to a "marginal location" i.e., "a location with less than average calling." Second Order ¶ 46. This approach requires carriers to pay excessive compensation for every compensable call at every payphone. Id. ¶¶ 46-50.

[18] Second Order ¶ 93 ("reliance on cost studies, in general, could reduce the revenues recovered by the PSPs, and therefore, might reduce the number of payphones deployed.").

above, the D.C. Circuit expressly observed that the evidence demonstrates that dial-around capabilities cannot effectively constrain compensation for coinless calls because carriers cannot costlessly prevent callers from accessing their networks from payphones and thus imposing payphone usage charges on them. And to the extent the Commission was relying on the fact that the local coin market is competitive, competition in that market cannot prevent PSPs from extracting monopoly rents in the market for coinless calls.

The Second Order's conclusion that payphones are not a "bottleneck" facility for carriers is also contradicted by arguments made by the PSPs themselves in the remand proceeding. In particular, the RBOC/GTE/SNET Coalition argued that local coin and coinless toll call compensation rates should be set on the basis of the relative elasticity of demand in these two markets -- i.e., on the basis of "Ramsey pricing." See Coalition Comments at 21-24. As explained without contradiction by AT&T in its Reply (at 6 n.14) and its September 24 ex parte, Ramsey pricing assumes the existence of monopoly power over two different products. And even if the market for local coin calls is competitive, using Ramsey pricing principles to set the payphone compensation rate for coinless calls would guarantee monopoly pricing for such calls.

Fourth, the Second Order's concern about recovery of common costs is a straw man. AT&T and other parties that advocated a forward-looking pricing standard recognized that the default rate should include common and overhead costs in addition to direct, incremental costs. All of AT&T's cost figures on remand reflected PSP recovery of appropriate common costs.

In sum, the Second Order failed to seriously consider numerous, substantial arguments presented in the remand proceeding that its market approach was arbitrary and would greatly overstate payphone compensation rates. The order also dismissed out of hand arguments showing that a bottom up, economic cost standard was the only economically sound approach.[19] Rather, the Second Order merely made slight amendments to an approach that is fundamentally defective. Such incremental tinkering plainly fails to satisfy an agency's obligation to take a serious look at the evidence presented on remand.[20]

IV. The Second Order Erred In Relying On IPP Cost Data To The Exclusion Of Relevant Data Regarding LEC PSPs' Costs.

Exacerbating the fundamental flaws in the Second Order's market rate approach was its decision to rely almost exclusively on data provided by the American Public Communications Council ("APCC") and other independent payphone providers ("IPPs"). In order to implement its duties under the Act, the Commission properly requested data regarding the average monthly costs and payphone usage. 11 FCC Rcd 6716, 6736 (1996). The RBOC/GTE/SNET Coalition, however, generally refused to produce any usable cost data and instead baldly asserted that their average total costs per call ranged from 34 to 37 cents.[21]

Rather than condemn the LECs' obvious stratagem, the Second Order instead moves forward using almost exclusively the cost data supplied by IPPs, which the APCC claimed was an average of 43.5 cents per call (based on average monthly costs in the study group of about $240 per phone and 689 average calls per month).[22] The Second Order (¶ 48) defended the

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[19] See Yakima Valley Cablevision, Inc. v. FCC, 794 F.3d 7373, 74 n.36 D.C. Cir. 1986) ("[t]he failure of an agency to consider obvious alternatives has led uniformly to reversal.").

[20] See ALLTEL Corp. v. FCC, 838 F.3d 551, 558 (D.C. Cir. 1988) ("[s]oftening an arbitrary and capricious rule does not necessarily cure it.").

[21] In this regard, it should be noted that the LECs failed even to comment on the fact that in 1996 they stated that their total costs were only 25 to 32 cents per call. To the extent that the LECs increased their 1997 figure on the basis of their claim that Flex ANI implementation costs were from 5 to 8 cents, those claims were rejected in the Second Order, and they have now been shown to be flatly wrong. See Part V.D below.

[22] Specifically, the Commission used the IPP cost data to determine the number of calls a PSP would need to cover its total costs (at a "marginal location"). Second Order ¶¶ 48-50. This number was then used (in conjunction with other data) to estimate the net avoided costs of

(footnote continued on next page)

use of the IPP data by stating -- without any citation to the record -- that these data were "representative of the payphone industry as a whole."

But this assertion is invalid on its face. As the Second Order (¶ 60) itself recognized, "most payphones are . . . owned by large local exchange carriers." See also First Order ¶ 9. IPPs, by contrast, operate only about 20 to 25 percent of all payphones. And as shown below, they also typically have much higher costs than LEC PSPs.

The assertion that IPP costs are reflective of the industry is also contrary to the record evidence.[23] As noted above, the RBOC/GTE/SNET Coalition refused to come forward with virtually any usable cost data. The only reasonable inference from the LECs' failure to provide the Commission with such evidence is that, if produced, it would show that LECs have much lower costs than IPPs. Indeed, this fact is evident even from the costs summarily claimed by the LECs in 1996, when they opined that their average cost for a payphone call was between 25 and 32 cents, much lower than the IPPs' figure of 43.5 cents. AT&T Oct. 1, 1997 ex parte.

Moreover, the Second Order arbitrarily discounted the data by the one LEC (Sprint) that did provide detailed cost numbers as requested. This evidence showed that Sprint has average total costs of only $100 per month and less than 25 cents a call based on its actual call volumes -- significantly less than the IPP cost figures. Nevertheless the Order (¶ 101 n.267)

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coinless calls (6.6 cents per call), which was subtracted from the assumed market rate for local coin calls (35 cents per call) to arrive at the default rate (28.4 cents per call). Id. ¶¶ 51-63.

[23] See City of Brookings Municipal Tel. Co. v. FCC, 822 F.2d 1153, 1165 (D.C. Cir. 1987) (to withstand appellate review, a court must be able "to discern" a "rational connection between" the "agency decision" and "the record").

rejects the Sprint data, stating that Sprint "has a significantly different organizational structure and payphone base from that of [IPPs]." This is patently irrational.

The Second Order decreed that because Sprint is different than the IPPs, it costs are not representative. However, Sprint is more representative of the PSP industry -- most of whom are LECs -- than any individual IPP, or even the APCC. Sprint's data should also provide a fair representation of PSP costs, because its phones are geographically dispersed in many regions of the country, including many rural areas, and it has more payphones than any individual IPP but fewer payphones than any RBOC or GTE.[24]

In other words, the Second Order gave the Sprint evidence no weight simply because it was different from the evidence submitted by a minority segment of the payphone industry. But whether Sprint's cost data were "different" from the IPPs' cost data is irrelevant. The pertinent issue was whether the Sprint data were reliable, and there can be no serious dispute as to that question.

The Second Order (¶ 70) also cast aside evidence from a state regulatory proceeding showing that NYNEX had informed the Massachusetts DPU that its average per-call cost was 16.7 cents. The order's refusal to consider this evidence is also irrational -- especially in light of the Coalition members' general refusal to provide other usable data for the Commission to review. And in all events, the Second Order is at best vague in stating why it would not consider the same information that was reported by the Massachusetts DPU in a published order. The only conceivable explanation is that the LECs' argued that these cost data were irrelevant because they were based on "incremental" costs.[25] But even if this were true,

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[24] The Sprint data may also be more reliable than the IPP data in light of the fact that Sprint is both an IXC and a PSP.

[25] The Second Order's reference to the fact that NYNEX claimed confidential treatment for the data is not a reasonable basis to completely reject them. The Commission could clearly have crafted a confidentiality order that would have addressed such concerns while at the same time allowing the critical information to be considered.

NYNEX asked the Massachusetts Department of Public Utilities for a 25 cent per call rate for coin calls on the basis of these data, thereby providing a strong indication that its total costs are below 25 cents per call. And in all events, NYNEX's "incremental" costs of under 17 cents per call refute the Second Order's unsupported conclusion (¶ 48) that IPPs' claimed costs of over 40 cents per call are "representative of the payphone industry as a whole."

Finally, the shortcomings in the record due to the absence of cost data from members of the RBOC/GTE/SNET Coalition can be rectified by evidence that has just now become available for use. As explained by David Robinson in his accompanying affidavit, AT&T has just recently obtained unrestricted access to an in-depth analysis by Southwestern Bell Company ("SBC") of the costs incurred in operating its payphones.[26] The SBC study conclusively demonstrates that the IPP cost evidence is substantially overstated. As set forth in Mr. Robinson's affidavit (¶ 8), the average monthly cost for an SBC payphone is $93.11. Not only is this figure less than 40% of the cost figure submitted by APCC, it is directly in line with Sprint's average monthly cost of $100.

Further, even on the basis of lower call volumes for SBC payphones, the Robinson Affidavit (¶ 9) shows that SBC's average total cost of a coin call is only 19.5 cents, including the cost of commissions. If commission costs are removed, SBC's total costs are only 16.2 cents per call. This is even lower than Sprint's costs, and remarkably similar to the NYNEX data for Massachusetts. Accordingly, all available data point to the fact that LEC PSPs -- who operate the vast preponderance of payphones -- have significantly lower costs than IPPs. Thus, there is no basis for the Second Order's decision to dismiss the Sprint (or NYNEX) data as "not representative."

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[26] This SBC study, which was provided to AT&T by a third party at a time when SBC was considering selling its payphone business, could not be used during the remand proceeding because it was covered under the terms of a confidentiality agreement that expired on October 3, 1997 (Robinson Affidavit, ¶ 2).

In sum, by failing to provide the most significant evidence, the LEC PSPs were able to hide behind the much higher costs submitted by the IPPs to generate an overstated "industry average." Rather than condemn the LECs' refusal to comply with the Commission's requests, the Second Order (¶ 49 n.124) assumed -- without any foundation and contrary to the information in the record -- that the IPPs' evidence was "representative of the payphone industry average." The detailed cost evidence now available from a member of the dominant segment of the PSP industry enables the Commission on remand to rectify the earlier errors and set payphone compensation rates that are based on data that are truly representative of PSPs' costs.

V. The Second Order's Application Of Its Market Rate Standard Was Arbitrary And Generated An Excessive Compensation Rate.

The Second Order also committed several independent errors in calculating the avoided costs of coinless calls. In particular, the order selected a market rate that was contrary to the record evidence, failed to treat PSP profits appropriately, deducted too small an amount for the costs of completing local coin calls, and added too much cost for the implementation of Flex ANI. The net effect of these mistakes was a default rate that is excessive even under the Commission's own (flawed) standard.

A. The Market Rate Adopted By The Second Order Is Too High.

The Second Order used a market rate of 35 cents as the starting point for its avoided cost analysis. This decision was based on the statement that five out of the seven states that had deregulated payphone rates had such a rate. Second Order ¶ 12 n.33. The order, however, gave no reason for choosing that rate, as opposed to the 25 cent rate that exists in the two other states that have deregulated payphone rates -- or in Massachusetts, where NYNEX requested a 25 cent rate. Using the 25 cent rate would be perfectly proper in the instant case, because PSPs are now free, for the first time, to set their local coin rates at a market rate, and they will be receiving compensation for the first time on 800 subscriber calls, which represent a large majority of all compensable coinless calls.

Moreover, a market rate of 35 cents per call is excessive when compared to the average total costs of the LECs discussed above -- Sprint (25 cents), NYNEX (16 cents), and SBC (19.5 cents). And in all events, the Second Order provided no credible explanation why it picked the highest conceivable rate rather than pick a rate consistent with these figures. See ALLTEL, 838 F.2d at 558 ("[T]he Commission must do more than simply ignore comments that challenge its assumption and must come forward with some explanation that its view is based on reasonable analysis.").

B. The Second Order Failed To Deduct The Profit On Avoided Costs.

The Second Order also failed to account reasonably for the profits on avoided costs. By definition, a rate includes a component to cover costs and a profit. The Second Order, however, only removed net avoided costs (6.6 cents) from that rate, leaving the profit component associated with those costs undisturbed. In other words, it provided PSPs a higher profit margin on coinless calls than the assumed profit on local coin calls.[27]

Even if PSPs' specific profit margin on access and toll free calls could be the subject of reasonable debate, allowing a higher margin than the one permitted for local coin calls -- which are now priced at a market rate -- cannot be deemed "fair compensation." Indeed, the entire market rate approach is premised on the fact that the local coin call rate is a rate set by effective competition. Second Order ¶ 9. By assuring that PSPs will earn a higher rate of

[27] See AT&T Comments at 14 ("In addition, the Commission should increase [its avoided cost] figure to assure that it excludes . . . any profit associated with handling coin (as opposed to coinless) calls."). This is in stark contrast with the avoided cost methodology the Commission developed pursuant to sections 251 and 252 of the Act, 47 U.S.C. §§ 251-52. There, the Commission expressly treated as avoided the profit associated with the avoided capital costs. Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket No. 96-98, ¶ 913 (Aug. 8, 1996).

return on coinless calls, PSPs will be earning supra-competitive profits on such calls.[28] See Farmers Union Cent. Exch., Inc. v. FERC, 734 F.2d 1486, 1503 (D.C. Cir. 1984) (striking down agency decision that permitted rates that included monopoly rents). Thus, any avoided cost analysis should take into account the profit on those avoided costs.

C. The Second Order Deducted Too Small An Amount For Local Call Completion.

The Second Order (¶ 54) deducted an average cost of 2.75 cents per call for local call completion. Even under the Commission's own analysis, this is far too little. The record evidence overwhelmingly demonstrated that at least 5-8 cents should be deducted. This translates into an additional avoided cost of 2.25-5.25 cents per call.

The Second Order (¶ 52-53) recognized that payphone set costs relating to coin handling should be deducted in calculating payphone compensation and applied directly to the price of local coin calls, even though the PSP pays a single price for the set. This principle, however, was short lived. In the very next paragraph, the Second Order (¶ 54) merely notes that with regard to payphone line costs, sometimes lines are completely flat-rated, sometimes they have a usage-based component, and sometimes the PSP has a choice of the type of line to purchase. In that paragraph, the order then calculates avoided line costs using figures provided by PSPs which made no deduction for flat-rated lines, even though it was not -- and cannot be -- disputed that payphone lines, like payphone instruments themselves, serve two distinct functions. Hence, the order made no effort to assign a portion of the line costs that are used to complete local calls to costs of coin calls, even though PSPs have complete flexibility to do this under the Commission's rules.

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[28] As noted above, PSPs' acknowledged ability to earn monopoly profits in the coinless call market is also made clear by their suggestion that the Commission should use Ramsey pricing to set the payphone compensation rate.

This decision ignored entirely AT&T's argument (Reply at 25-27) that the fact that many PSPs have shifted to purchasing flat-rate pricing does not demonstrate that there are no costs associated with completing a local coin call. Rather, it means only that LECs are changing the way they recover line costs. By failing to take into account these facts, the Second Order has allowed LECs to double recover those costs -- once from PSPs and a second time from carriers who will pay the LECs' PSP affiliate. Even more important, the analysis used to determine the avoided costs for payphone lines is directly inconsistent with the analysis used to determine the avoided costs for payphone sets. Such "internally inconsistent" decision making is plainly "unreasonable and impermissible." See Air Line Pilots Ass'n v. FAA, 3 F.3d 449, 453 (D.C. Cir. 1993). The effect of this inconsistency is significant. Based on direct information provided both by the LECs and APCC, where LECs charge separately for the costs of local coin call completion, the per-call charges typically range from 5 to 8 cents. AT&T Reply at 27. Accordingly, the Commission should increase the line costs avoided from 2.75 cents to 5 to 8 cents.

D. New Evidence From USTA Confirms That There Should Be No Add-On For Flex ANI Costs.

The Second Order (¶ 57) increased the payphone compensation rate by 1 cent in order to cover PSPs' costs for paying LECs $600 million for implementing Flex ANI. In setting this amount, the order relied entirely on cost estimates from USTA. Id. ¶ 57 n.151. There is now no question that the USTA study upon which the Commission relied was substantially flawed. Indeed, after the Second Order was issued, USTA has revised its estimate to one-tenth of its former figure -- $61.2 million.[29] At a minimum, this means the 1 cent add-on imposed by the Commission must be slashed to no more than one tenth of a cent.

[29] Letter from Keith Townsend, USTA, to John Muleta, CC Docket No. 96-128, dated October 24, 1997. In the letter, USTA stated that the costs for implementing Flex ANI in equal access offices would be $61.2 million. In subsequent proceedings on the Bureau's Waiver Order there was virtually unanimous concurrence that Flex ANI implementation should

(footnote continued on next page)

Indeed, the de minimis nature of these costs reinforces AT&T's argument -- which was not addressed by in the Second Order -- that these costs should not be recovered at all. As AT&T explained (Reply at 28-31), the costs for establishing the delivery of Flex ANI are properly borne by the PSPs as a set-up cost for receiving payphone compensation. Without real-time access to ANI codes, carriers have no ability to block payphone calls and therefore do not have the bargaining power upon which the Commission relied in establishing the market rate approach. In addition, AT&T and other carriers had to spend tens of millions of dollars to track payphone calls and collect the money necessary to remit payments to PSP -- but this amount was not taken into account by the Commission in its avoided cost approach. Thus, PSP should not be entitled to pass on to carriers and customers the PSPs' implementation costs for a system that will generate billions of dollars in revenue for them over the next few years.

CONCLUSION

For the reasons set forth above, the Commission should reconsider the Second Report and Order and reject the order's market-based approach to per-call compensation in favor of a bottom-up cost approach consistent with that recommended by AT&T in its Comments and Reply on remand. In all events, the Commission must recognize that the IPP costs relied upon in the Second Order are not representative of the costs of PSPs as a whole and recompute the cost analyses in the order. In order to do so, the Commission must either demand that LEC PSPs provide verifiable data regarding their actual costs, or rely upon the data regarding Sprint, NYNEX and SBC. Finally, if the Commission persists in applying an economically inefficient "top down" avoided cost approach, it should lower the currently prescribed per-call

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only be required at equal access offices (see AT&T Reply, CC Docket No. 96-128, dated November 6, 1997, p. 5). Thus, there is no basis for including more than $61.2 million in costs in calculating the per-call compensation rate.

compensation rate to (i) reflect a starting point of 25 cents; (ii) deduct excessive profits relating to avoided costs; (iii) increase the avoided cost for local call completion to 5-8 cents; and (iv) eliminate the cost add-on relating to the delivery of Flex ANI. Only in this way can the Commission avoid the PSP windfall that has resulted from the current payphone orders and assure that carriers and customers will pay PSPs "fair" compensation for use of their payphones.

Respectfully submitted,

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